United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

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76-1262

To be argued by
MICHAEL I. SALTZMAN

In The

United States Court of Appeals

For The Second Circuit

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

vs.

HARVEY OST,

Defendant-Appellant.

BRIEF FOR DEFENDANT-APPELLANT

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For The Second Circuit

Docket No. 76-1262

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

vs.

HARVEY OST,

Defendant-Appellant.

PRELIMINARY STATEMENT

Harvey Ost appeals from the judgment of conviction entered against him on October 31, 1975 in the United States District Court for the Southern District of New York, after a two-day trial before the Hon. John M. Cannella, sitting without a jury.

Indictment 75 Crim. 391 filed on April 15, 1975, charged Harvey Ost (the "defendant") in two counts, with wilful attempted evasion of the individual income tax of himself and his wife for the calendar year 1968 in violation of §7201 of the Internal Revenue Code of 1954 (the "Code"), 26 U.S.C. §7201; and with wilfully making and subscribing a verified tax return he believed to be false as to a material matter in that he understated the amount of short term capital gains of himself and his wife for 1968, in violation of §7206(1) of the Code, Title 26, U.S.C. §7206(1).

Trial began on September 22, 1975 and concluded on September 24, 1975. After the filing of post-trial memoranda, Judge Cannella found defendant guilty on each count, in an unreported opinion set forth in appellant's appendix.

On May 26, 1976, Judge Cannella sentenced defendant to a period of imprisonment of four months on Count 1 and three years on Count 2 with execution of the sentence on Count 2 suspended. Defendant was placed on probation for a period of three years subject to the standing probation order of the Court. In addition, the Court fined defendant $5,000 on Count 1 and $5,000 on Count 2.

Defendant has been released on bail pending appeal.

QUESTIONS PRESENTED

1. When substantial independent evidence to prove an element of the crimes charged is lacking, may a defendant nevertheless be convicted of those crimes, based on circumstantial evidence tending to prove the defendant's general consciousness of guilt?

2. When the defendant was charged in the indictment with wilful evasion and a false statement with respect to his individual income tax and the evidence at trial taken as a whole tended to establish that defendant and others may have attempted to evade the income tax of their corporation, was there a fatal variance between the indictment and proof?

STATEMENT OF FACTS

The evidence presented at the trial in the court below tended to show that the defendant and his two fellow shareholders in Weinberg, Ost & Hayton, Inc. attempted to evade a substantial portion of its income tax for the year 1968, by omitting the trading profits from a nominee account. The

indictment charged, and the Government contended, however, that defendant had wilfully attempted to evade a substantial portion of his individual income tax for the year by failing to report the trading profit (short-term capital gains) on the 1968 federal income tax return he prepared, signed and filed on behalf of himself and his wife. While the trial court acknowledged that the Government had presented little direct evidence that the defendant had received the gains from the nominee account, the Court nevertheless found the defendant guilty of wilful evasion of tax on this amount as well as a false statement on his 1968 tax return, by relying on circumstantial evidence from which he drew inferences of the defendant's consciousness of guilt.

In 1968, Sidney Weinberg, Edward Hayton and defendant were the owners of the stock of Weinberg, Ost and Hayton, Inc. ("WOH"), a stock brokerage firm specializing in over-the-counter securities (5a, 113a, 122a).* Weinberg was the President of the company, while Hayton and the defendant were also officers of the firm (113a, 144a, 160a). Each of the shareholder-officers handled separate and distinct activities of the business. Weinberg conducted the trading of stock and securities the firm did for its own account (6a, 42a, 113a, 144a-145a). Hayton supervised the salesmen and dealt with the mutual fund business and underwritings (6a, 144a). The defendant directed the record-making and cashier functions or "back office" of the firm (5a, 50a, 161a).

There were five trading accounts at WOH — that is, accounts for which securities were purchased and sold usually on the same day for the risk of the firm (41a, 113a). The account which Weinberg traded was different from the other four trading accounts, however. All profits from the account Weinberg traded ("A") went to WOH, while Alvin Cohen and the three other traders divided the trading profits from their accounts with

* References followed by the letter "a" are to the appellant's appendix, which is the joint appendix for the purposes of this case. "GX" and "DX" refer to Government's and defendant's exhibits in evidence, respectively.

WOH on a 50-50 basis (42a, 43a, 61a). The transactions for trading accounts were characterized by quick purchases and sales of securities usually on the same day (44a). Defendant himself did not conduct trading for a firm account (61a-62a). Also, no commissions were charged against any trading account (43a, 94a), although commissions were generally charged by WOH on customers' accounts (43a), except for certain favored accounts (73a).

During 1968, the volume of trading on Wall Street was extraordinarily heavy (48a). The hours the exchanges remained open were shortened and certain trading days were suspended to permit the back offices of firms to catch up with paperwork (59a, 122a). Because of the heavy burden placed on the back offices of firms, their workers were in demand and either left or were induced to go from one firm to another (48a). There was also talk among back office workers about the size of the bonuses they would receive for the heavy volume of work they were handling and the long hours they were working (49a) and large bonuses were generally expected (49a, 206a).

Defendant directed the overall operations of the back office at WOH (50a). However, the clerical personnel were under the direct supervision of James V. O'Brien, whose title was Chief Cashier (6a, 47a). Arnold Freilich was the Assistant Cashier (195a). WOH's record-keeping fell behind during the year (59a) and a tremendous amount of paperwork had not been done by the clerical workers under O'Brien's supervision (59a). The back office did not catch up during the year and by October many entries which should have been made the same day were made many days later (60a) and necessary supervision of the clerical workers was not given (60a). Defendant demanded a high level of performance from the back office workers who were faced with heavy volume and long hours (48a, 201a, 202a). There was a personality conflict between O'Brien and defendant (35a-36a), and O'Brien and others in the back office resented his interference and manner (51a, 201a, 202a).

A. The Feferholtz Account

In or about August, 1968, during this hectic period for the back office operations of WOH, dissatisfied back office workers led by O'Brien met with Hayton in his office (50a, 51a-53a, 115a, 145a-146a, 166a). Weinberg was present at the meeting (115a), but defendant was excluded (115a-116a). O'Brien told Hayton that defendant was making a fool of himself with back office employees, was being obnoxious and back office workers wanted to leave (51a). O'Brien insisted that he and others would leave unless defendant kept out of the back office (51a, 53a, 115a, 145a-146a) and the large bonuses the workers expected were paid (52a, 115a, 145a-146a, 206a).

After the meeting with O'Brien and the others, Hayton and Weinberg met with the defendant (115a-116a, 146a, 166a-167a). As a result, defendant agreed to stay out of the back office. Defendant occupied himself at that point with handling the considerable number of customer complaints which were developing out of the bad record-keeping situation in the back office (166a-167a). Another consequence of the meeting was that on September 3, 1968, an account in the name of Selma Feferholtz was opened at WOH (89a, 116a, 146a, 167a, GX-35). It was common knowledge in the back office that Selma Feferholtz was the defendant's wife (39a, 40a). The address of the account was the address for defendant's mother (12a, GX-36). A customer ledger rather than a trading ledger was set up for the account, but the customer ledger for the Feferholtz account was kept with defendant rather than with the other customer ledgers (15a, 71a-72a). The initial transactions in the Feferholtz account were deposits totalling 150 shares of Metallurgical International, which were transferred from the WOH trading account "A" (14a, 88a). These shares received for no money were sold for $5,370 (14a).. After the Feferholtz account was opened, on 27 occasions securities were sold on the same day they were purchased, and, in one instance, securities were sold four days after they were purchased (13a, 14a, GX-35).

Weinberg conducted the trading for both the Feferholtz account and trading account "A," and only the most profitable trades for a day were chosen for the Feferholtz account (116a-117a, 146a, 171a-172a). This was the same type of transaction carried on for the trading accounts (44a), and no commissions were charged against the Feferholtz account (44a), as was the case with the trading accounts (44a).

B. The Proceeds of the Feferholtz Account

Trading profits were drawn out of the Feferholtz account (14a). Defendant instructed O'Brien to prepare WOH checks and bring them to him (15a-16a). A total of 18 checks were drawn against the account, the gross amount of which was $32,425 (14a). The proceeds were deposited in the firm's vault (119a, 147a, 172a). The Feferholtz account was closed on November 19, 1968 (11a-12a, GX-35). O'Brien left WOH at or about that time to start a brokerage firm which would be a competitor of WOH (6a, 33a, 38a). Before he left WOH, however, O'Brien made a photostat of the WOH customer ledger for the Feferholtz account to use as a means of protecting himself against any action by defendant (35a).

Once O'Brien left the firm to go into competition with WOH, WOH decided not to pay O'Brien any bonus at all from the proceeds of the Feferholtz account (118a, 147a, 172a-173a). Other back office workers were paid bonuses but not out of the Feferholtz account proceeds (136a). However, at about the time of O'Brien's departure, another purpose for the fund developed.

Before December, 1968, the defendant and a friend and neighbor, Jerome Cohan, had discussed the possiblity of a loan to WOH (100a-101a, 118a-119a, 175a). Cohan was the executor of his mother's estate, and he wanted to invest money of the estate (101a, 175a). On December 3, 1968, a loan agreement between WOH and the Estate of Sadie Cohan was entered into whereby the Estate loaned $100,000 to WOH at 9% interest for a

term of 13 months (January 3, 1970) (103a, DX-D2). In addition, Weinberg, Hayton and defendant personally assumed joint and several liability for the repayment of the loan and executed a confession of judgment to be used in the event of default (150a, DX-[illegible]. On the execution of the loan agreement and confession of judgment, a check in the amount of $100,000 payable to the order of WOH was delivered to the firm (102a, DX-C).

In 1969, WOH became less profitable than it was in 1968 (194a) and on December 29, 1969, WOH was able to secure an extension of the Cohan loan at an increased rate of interest (103a, DX-D-1). In October, 1970, however, WOH went out of business (181a). The Cohan loan was nevertheless paid in two installments (104a). Defendant told Cohan, however, that he had put aside cash to repay the loan (109a-110a). On or about October 28, 1970 defendant offered to repay Cohan the first installment of the loan in currency (110a). Cohan demanded payment by check (110a), and, accordingly, a cashier's check was purchased with cash from the WOH vault and paid on behalf of WOH to Cohan (105a, 119a, 147a, 179a, DX-E). The remaining $50,000 installment was repaid to Cohan in 1971 from the proceeds of a tax refund the company received on account of the carryback of 1970 losses to the years 1967, 1968 and 1969 (157a, 159a-160a, DX-I, DX-J, DX-K).

C. Circumstances Prior to Trial

The tax return of WOH for its taxable year 1968, which was signed by Hayton, did not reflect the short-term capital gains realized on the Feferholtz account (153a, GX-24). With a few minor exceptions the individual tax return of defendant and his wife for 1968 reported the gains and losses on stock transactions for the Selma Ost account at WOH (95a-96a). The 1968 individual income tax returns filed by O'Brien and his wife, Freilich and Freilich's father-in-law omitted substantial amounts of income (7a, 195a-197a).

In 1971, O'Brien's 1968 tax return came under investigation for possible tax fraud and Special Agent James King contacted the defendant in April 1971, to obtain records pertaining to O'Brien's account at WOH (79a). Defendant gave King full access to the WOH records (86a). When records in addition to the ones defendant supplied to King were requested, the defendant took King to a room at the Hayton Corporation offices where the records of the then defunct WOH were stored and told King the WOH records were in the room (79a-80a). King made visits to the storage room at Hayton Corporation during 1971 and 1972. He generally obtained a key to open the storage room at the Hayton Corporation offices where the WOH records were kept, but he saw the storage room door ajar on a number of occasions (84a-85a). Occasionally King worked after Hayton Corporation's offices were closed, and he left the storage room key in the mail opening for packages or bulk mail in the door of the office (85a). During his investigation of O'Brien, King examined the WOH cancelled checks for 1968 he found in the storage room (80a). In 1972, one of the people sharing space at the Hayton Corporation told him that she believed certain individuals had used nominee accounts at WOH (78a). King could not find any WOH cancelled checks for the Feferholtz account (80a). King also attempted to find WOH daily blotters for the period from September 3, 1968, through November, 1968. Pages from the daily blotter volumes were missing and he was able to find only one daily blotter which reflected a transaction for the Selma Feferholtz account (81a).

Some time prior to March 31, 1975, O'Brien met with representatives of the United States Attorney's office and worked out an agreement with the Government (7a). Pursuant to that agreement O'Brien produced the photostat of the Selma Feferholtz account which he had copied in 1968, when the defendant's name came up in the investigation (39a). On March 31, 1975, an information was filed charging O'Brien with having evaded federal income tax on approximately $75,000, of income for the year 1968, and on $8,000 of income for the year

1969 (7a). Pursuant to the agreement, O'Brien entered a plea to the count of the information pertaining to the year 1968 (6a-7a).

On March 15, 1975, the statute of limitations on a prosecution of Weinberg, Hayton and defendant for evasion of the corporate income tax of WOH for the year 1968 expired. However, on April 15, 1975, the last day for the filing of an indictment with respect to alleged criminal tax violations on his individual tax for the year 1968, an indictment was returned against the defendant charging him with evading tax and making a false statement as to the income represented by the Feferholtz trading account proceeds.

Also on April 15, 1975, Freilich's father-in-law was indicted and charged with evading federal income tax of approximately $35,000, for the year 1968 (196a). Freilich's father-in-law also reached an agreement with the Government pursuant to which he agreed to cooperate with the Government, and, to help his father-in-law, Freilich agreed to cooperate as well (196a).

D. The Trial

1. The Government's Case

The Government's direct case consisted of 38 documentary exhibits and on the issue of the Feferholtz account, the testimony of O'Brien and Special Agent James King. O'Brien testified that on more than one occasion he located the WOH customer ledger in the defendant's custody (15a), that the defendant gave him instructions to prepare checks of WOH to be debited against the Feferholtz account (16a) and that he delivered these checks to the defendant (16a).

O'Brien described his agreement with the Government concerning his tax evasion, and his belief that supplying the photostat to the Feferholtz account would be helpful to him at the time of sentencing (7a, 38a).

O'Brien's testimony established not only a bitter feud between O'Brien and defendant both during and after 1968, but also his fear and suspicion that defendant would harm him in some way. Apart from the pressures in the back office, O'Brien was seeing a psychiatrist during 1968 and afterwards (71a). In the course of his testimony concerning the back office situation at WOH during 1968, O'Brien belittled defendant as "making a fool out of himself with employees" and "being obnoxious" (51a). At the same time O'Brien expressed fear that defendant might do something to hurt him after he left WOH because he believed defendant was "a very vindictive person" (35a). The photostat was made to remind defendant he could not "make trouble" for O'Brien (35a). After O'Brien left WOH, there was "no love lost" between O'Brien's firm and WOH, or between O'Brien and defendant (38a).

O'Brien had, prior to trial, told Special Agent King that the initial deposit of 50 shares had come out of trading account "A," as had another 100 shares of Metallurgical International (85a-88a). At trial, O'Brien testified that he "suspected" the 50 share deposit was of missing stock he could not locate during an audit and had asked defendant about (45a-47a). When asked, O'Brien said he could not recall telling King that the 50 shares had come from trading account "A" (69a-70a).

O'Brien also reported a conversation he said took place between himself and defendant in 1971 (25a-27a). This was after O'Brien's leaving WOH to start a competitor firm and when he said there was no love lost between them. O'Brien was under investigation for tax fraud at the time. WOH was defunct and the meeting took place at the offices of Hayton Corporation. Yet at this meeting, O'Brien said defendant gave him two cancelled WOH checks drawn to the order of O'Brien's wife (GX-22, GX-23) and offered to leave the Hayton offices open and "it would not be a bad idea to have a fire" (27a).

Special Agent King testified as to the missing cancelled checks (80a), and the missing daily blotter pages for the period September 3 through November, 1968 (81a, GX-37), as well as to seeing the door of the room in which WOH records were kept ajar on a number of occasions (85a).

King conceded that if the Feferholtz account was a trading account, it might indicate a corporate rather than defendant's personal account (90a). The fact that Selma Feferholtz was the maiden name of defendant's wife suggested to him that the account was the defendant's or his wife's (94a). But the fact that all trades, except one, were made on the same day did not indicate to him that the account was a trading account (89a-90a); nor the fact that no commissions were charged (90a-91a); nor the fact that every trade in the account generated a profit (91a) while even Weinberg's trading account A did not always have a profitable trade (91a-92a). King also testified that, except for a few minor transactions, gains and losses for the Selma Ost account at WOH were reported on defendant's 1968 return and that not all the transactions for this account were profitable (95a-96a).

The Government failed to offer evidence that defendant actually received the proceeds of the Feferholtz account for his own benefit, or that by virtue of circumstantial evidence of unaccounted-for bank deposits or increases in net worth or expenditures, he had understated income for the year 1968.

2. The Defendant's Case

The defendant's explanation was that the Feferholtz account was started in September 1968 as a company trading account which was initially for the purpose of accumulating funds for the payment of bonuses to employees pursuant to the demand of O'Brien. Subsequently, when O'Brien left, the payment of bonuses of the size that O'Brien demanded was no longer necessary and the amount was kept in part as security for the repayment of a loan obtained from Jerome Cohan.

O'Brien on cross-examination corroborated the meeting in August or September, 1968 at which he stated to Hayton and Weinberg that he and others would leave WOH unless Ost stayed in the front office and bonuses were paid (50a-53a). The Government's rebuttal witness Freilich confirmed the general back office discontent and expectation of a demand for substantial bonuses for the year (201a-202a, 206a-208a).

Jerome Cohan corroborated the making of a loan to WOH in December, 1968 in the amount of $100,000 (102a), the defendant's representation that cash had been put aside to secure the loan (109a-110a), his offer to pay $50,000 in cash (109a), as well as the ultimate payment made by check delivered to Cohan's attorney (109a).

Sidney Weinberg testified that he was the one who traded stocks and securities for WOH (113a). He testified that the Selma Feferholtz account was a firm trading account and that he did the trading for that account (116a-117a). He said the account was set up as the result of a meeting with O'Brien at which the employees demanded cash bonuses (115a-116a), and the account was to take care of cash bonuses (116a). He said that profitable trades would be put into the Selma Feferholtz account at the end of the day (116a) and that marginally profitable or loss trades were left in the regular trading account (116a-117a). Weinberg testified that WOH did not pay cash bonuses because they found out that O'Brien was leaving (118a). He said that thereafter the profits in the Feferholtz account were earmarked for a loan from Jerome Cohan and were used to insure repayment of the loan to Cohan by being kept in the firm vault (118a-119a).

On cross-examination Weinberg said he did not remember telling Assistant United States Attorney Wile that he had never heard of Selma Feferholtz or that he didn't remember trading for that account (123a). He denied the claim that he attempted to avoid a grand jury subpoena (123a-124a). Weinberg was

cross-exam ed on the accuracy of his own return. When questioned about the receipt of a $1,000 General Atronics bond which was not reflected on his tax return for the year 1968, although WOH records indicated delivery to him, Weinberg explained that the records of WOH were inaccurate in thousands of cases (137a). Weinberg could not recall whether he had an account in the name of Joan Cooperberg (his wife's name) and whether profits on the account were reported on his return (131a). On the other hand Weinberg's salary on the books of WOH was less than the salary reported on his tax return for the year (126a). Weinberg admitted that he was suspended by the SEC (124a-125a) and that WOH had been suspended by the NASD for bad record-keeping, and he believed the SEC had suspended WOH for grounds which were attributable to bad record-keeping (140a-143a).

Hayton testified that Weinberg ran both the trading account "A" and the Selma Feferholtz trading account (144a-146a). He also testified that the Selma Feferholtz account was started to pay cash bonuses as a result of the meeting with O'Brien (146a). Hayton said that the funds in the Selma Feferholtz account were not used in 1968 to pay bonuses because O'Brien left and that they were eventually used to repay the Cohan loan (147a). Hayton said that on an occasion he saw $50,000 in currency in the vault of the company (147a-148a).

On cross-examination, Hayton was pressed by the prosecutor to remember the names of the individuals besides O'Brien who were at the meeting which both O'Brien and Weinberg testified occurred in July or August, 1968 (151a), although O'Brien, who remembered the meeting also could not remember who else was there (52a). Hayton remembered that there were others at the meeting but did not recall the names of the employees because he did not work with the back office people (151a-152a). Hayton testified that the records of WOH did not reflect income from the Selma Feferholtz account but that he signed the WOH 1968 corporate tax return and the

profits of the account were reported so far as he knew (153a). Hayton said that the cash was in the vault for two years without getting interest to back up and assure payment of the loan because the defendant had indicated to Cohan that cash was there in the vault to repay at least 50% of the loan at all times (154a-155a). When the company closed in 1970 it did not have sufficient funds to pay the second $50,000 installment. It got those funds from the tax refund (156a).

The defendant testified that he had an account in the name of himself and in his wife's name at WOH in 1968 (161a). He testified, however, that the Selma Feferholtz account was not a personal account of himself or his wife and that it was formed after a meeting in late summer in Hayton's office (165a, 167a). The Selma Feferholtz account was opened to pay O'Brien and the others cash bonuses (167a-168a). He said that the Selma Feferholtz account had only profitable trades and that Weinberg would handle the trading and that at the end of the day profitable trades were chosen from the normal trading account "A" trades and put in the Selma Feferholtz account (171a-172a). He said subsequently checks were drawn against the Selma Feferholtz account, cashed and put in the corporate vault (172a). Bonuses were not paid from this fund because of O'Brien's departure to open a competing firm (172a-173a). Money was kept in the vault and used to pay the first installment of the Cohan loan (173a). The money was kept in the vault because Cohan was a friend and a neighbor and Cohan's attorney was concerned about security and in order to satisfy him he told him that the loan would be secured by cash in the vault (176a, 178a, 180a). Another reason for keeping the money in a vault was because of personal liability that each of the shareholders had to make repayment of the loan (180a). Defendant testified that the reason for the loan was the fear of consequences of bad record-keeping, missing stocks and lack of funds to make restitution (180a). Finally, defendant testified that when the profit in 1969 was substantially less than in 1968 and that when the loan was repaid in part in 1970, the only funds available were those proceeds of the Feferholtz trading account in the vault (181a, 182a).

On cross-examination defendant testified that he had declared his mother as a dependent although she had more than $600 in income from stock transactions in 1968 because he did not believe that this kind of income counted where dependency exemption was concerned (184a-185a). Defendant was questioned about a delivery of 6 General Atronics bonds (which the books erroneously referred to as stock (57a)) to Alvin Cohen, Weinberg, Hayton and defendant from the trading account Alvin Cohen handled at WOH. Despite the fact that the account involved was Cohen's account, the books indicated defendant had given instructions to charge the cost of the bonds to profit and loss statement of the firm (189a-190a). Defendant did not recall giving those and denied giving similar instructions in two other instances the WOH books ascribed to him (190a-191a).

3. The Government's Rebuttal

The Government offered Arnold Freilich as a rebuttal witness whose testimony was given pursuant to an agreement to cooperate with the Government to help his father-in-law, a WOH salesman who had pleaded guilty to tax evasion and was about to be sentenced (196a), prosecution for his own evasion having been barred by the statute of limitations (197a). Freilich testified that the defendant stated to him four months before trial that the Feferholtz account was set up so that Hayton could get 25% of profits to make payoffs to secure underwritings for WOH, Weinberg could get 50% to make payoffs to people in positions from which they could direct business to WOH, and that 25% of the profits were given to O'Brien for distribution to back office employees (199a). Freilich said he told defendant that he got no money from O'Brien and that defendant asked if he was willing to say he did receive $600 from O'Brien (199a). The defendant claimed, Freilich testified, that these false statements would discredit O'Brien, who would be the key witness against his father-in-law, another WOH trader and defendant (200a).

4. The Trial Court's Findings of Fact

At the conclusion of the trial, Judge Cannella filed an opinion stating his findings of fact. The Court found that the defendant's contention that the Feferholtz account was a firm trading account created to generate cash in order to make payments to b[illegible] office help was "inherently incredible." The Court also found that the three primary defense witnesses were incredible and their testimony not worthy of belief. If believed, the Court said, the story suggested that the Feferholtz account was created to generate income for WOH, on which no taxes were to be paid, income which was to be used for unreported cash payments to employees and income which was allegedly used to prefer one creditor over all others. The Court said that it "is not persuaded by the defendant's attempt to admit uncharged illegal activities as a means of convincing the Court that he did not commit the crimes charged."

The Court conceded that the Government had adduced little direct evidence to support the finding that the defendant received the proceeds of the Feferholtz account for his own use. Nevertheless the Court said that it was convinced beyond a reasonable doubt of the defendant's guilt based on the following factors (215a):

> "1. The 'explanation' upon which [defendant] based his defense, and the demeanor of the witnesses testifying to it was such that the Court finds it to have been a fabrication which strongly indicates consciousness of guilt. This conclusion is bolstered by the testimony of Freilich that four months before the trial, [defendant] had asked him to testify that he had received $600.00 from O'Brien. This attempt to discredit O'Brien and corroborate the 'explanation' further tends to demonstrate [defendant's] guilt.

2. The Feferholtz account was in the maiden name of defendant's wife and the address of his mother. These facts are totally consistent with a finding that [defendant] himself benefited from the account — and inconsistent with a finding that it was a firm account.

3. The books and records of WOH relating to the Feferholtz account have disappeared.

4. [Defendant] was responsible for instructing O'Brien to draw checks on the Feferholtz account and deliver them to him.

5. The fact that there were no commissions charged for trades in the Feferholtz account is not inconsistent with the finding that the account was not a firm trading account. Other favored individual accounts were similarly not charged commissions."

SUMMARY OF ARGUMENT

In this trial of defendant for evasion of and false statement with respect to his individual federal income tax, the Government had the burden of proving beyond a reasonable doubt that the proceeds of a nominee account at WOH, a corporate stock brokerage firm of which defendant was one of three shareholders, constituted defendant's taxable income and not the income of WOH. The Government produced evidence of defendant's conduct from which consciousness of guilt might be inferred. The other evidence at trial tended to show that the nominee account was set up and used for the benefit of WOH, and the Government failed to produce substantial independent evidence that defendant rather than WOH should properly have reported the income. We demonstrate this in Part A of Argument I, below. Despite the absence of substantial

independent evidence on the income understatement element of the crimes charged, the trial court erroneously based its judgment of conviction on the circumstantial evidence tending to show only defendant's consciousness of guilt. We explain this further in Part B of Point I.

The evidence at trial tended to prove not that defendant wilfully attempted to evade and made a false statement with respect to his individual tax, as was charged in the indictment, but that defendant and others attempted to evade the corporate income tax of their corporation by establishing a nominee account to trade in stocks and securities for the benefit of the firm. Accordingly, there being a variance between the proof and the indictment, defendant was convicted for a crime not charged by the grand jury in its indictment in violation of the Fifth Amendment of the Constitution. We discuss this in Argument II.

ARGUMENT

I.

CIRCUMSTANTIAL EVIDENCE TENDING TO ESTABLISH CONSCIOUSNESS OF GUILT WAS INSUFFICIENT EVIDENCE TO PROVE AN ESSENTIAL ELEMENT OF THE EVASION AND FALSE STATEMENT CHARGED; NAMELY, UNDERSTATEMENT OF INCOME.

This appeal involves the choice of the person taxable on gains realized from stock trading on behalf of a nominee brokerage account ("the Feferholtz account") maintained at WOH during the year 1968. Solely with respect to these gains, the District Court sitting without a jury, found the defendant guilty of having wilfully evaded the individual income tax of himself and his wife for the year 1968, in violation of §7201 of the Code, and of having wilfully filed a 1968 joint income tax return for himself and his wife containing a false statement as to a material matter, in violation of §7206(1) of the Code. The

judgment of conviction must be reversed since, even taking the evidence in a light most favorable to the Government, there was no substantial evidence to support the finding of the court below that defendant understated "his" income for the year 1968, by failing to report the gains realized on the nominee account on his 1968 tax return.

On the evasion count, the Government had at the trial in the court below the burden of proving beyond a reasonable doubt that (1) there was a substantial tax due from and owed by defendant for the year 1968, and (2) defendant wilfully attempted to evade or defeat that tax. *Holland v. United States,* 348 U.S. 121, 138 (1954); *Spies v. United States,* 317 U.S. 492, 499 (1943). Thus, one of the basic elements of the evasion offense is an understatement of tax, and a prerequisite to the imposition of tax is the establishment of taxable income. *Elwert v. United States,* 231 F.2d 928 (9th Cir. 1956); *Small v. United States,* 255 F.2d 604 (1st Cir. 1958); see also, *United States v. Gross,* 286 F.2d 59, 61 (2d Cir. 1961).

A taxpayer is only required to file a tax return reporting "his" taxable income. He is not required to report amounts which are taxable to another person. And developed principles concerning the person to whom items of gross income should be attributed provide that (1) compensation for services shall normally be attributed to the one who earns it, *Lucas v. Earl,* 281 U.S. 111 (1930); (2) income derived from property shall normally be attributed to the person who owns the property, *Helvering v. Horst,* 311 U.S. 112 (1940); and (3) where arrangements with respect to property make the choice of taxable person less clear, actual command over the property taxed rather than title will control, *Corliss v. Bowers,* 281 U.S. 376 (1930). These developed principles of the civil tax law apply as well in criminal cases, for there is no "double standard" for criminal and civil tax cases as to what constitutes taxable income. See, *DiZenzo v. Commissioner,* 348 F.2d 122, 126-127 (2d Cir. 1965). Thus, whether defendant's wife, or defendant

himself for that matter, were the nominee owner of the Feferholtz brokerage account at WOH in 1968, the defendant was not required to report as his own, the income from the account unless he earned the income, the stock in the account disposed of belonged to him, or he had command in the sense of absolute and unrestricted control of the profits or gains earned in the name of the account. In the context of this criminal prosecution of defendant, then, to be guilty of the evasion charged, the Government had the burden of proving beyond a reasonable doubt, and there must be substantial evidence to support a finding that defendant was the person required to report the gains from the Feferholtz account in 1968 and failing to do so, understated *his* taxable income for the year.

Similarly, on the false statement count the Government had the burden of proving beyond a reasonable doubt that the defendant (1) wilfully made and subscribed a verified 1968 joint income tax return (2) which he did not believe to be true and correct as to a material matter — the amount of short-term capital gains income reported. *United States v. Beasley,* 519 F.2d 233 (5th Cir. 1975). Thus, on this count also, a basic element of the false statement offense was the establishment that defendant had understated his income.

The error of the court below was that it drew inferences as to defendant's state of mind (consciousness of guilt) from evidence of defendant's conduct, without having before it sufficient independent evidence to establish the necessary element of the evasion and false statement offenses, that defendant had understated *his* 1968 income. However, the general rule is that inferences from such conduct will not supply a want of proof of a particular fact essential to a proponent's case. McCormick, *Law of Evidence,* §251, p. 539 (1954); 2 Wigmore, *Evidence,* §277. Thus a finding that defendant had additional unreported income for 1968, could be properly based not on generalized indications of consciousness of guilt, but solely on proof beyond a reasonable doubt that the proceeds of

the nominee trading account in question constituted the "income" of the defendant.

A. Evidence defendant understated his income was not substantial.

On the critical question of whether the income in question constituted defendant's "income," the Court candidly stated that the Government had "adduced little direct evidence to support a finding that [the defendant] received the proceeds of the Feferholtz account for his own use . . ." (214a). The little direct evidence, even when taken together with the circumstantial evidence the Court recited as the basis for its opinion does not support the finding that defendant received the proceeds of the Feferholtz account for his own use.

Evidence the Court considered established that defendant had received the proceeds of the Feferholtz account was the fact, well-known to everyone in the WOH back office, that Selma Feferholtz was the defendant's wife. The address for the account was the address of defendant's mother. From this evidence the trial court must have reached the conclusion the proceeds constituted income of the defendant by a two-staged inference: First, that Feferholtz being his wife's maiden name, the account was the defendant's account; and second, that the account being the defendant's account the proceeds constituted his income. If the Feferholtz account was in fact a trading account, however, that the true owner was WOH not the defendant would be indicated (90a). The evidence at trial was that, with one exception, the type of transaction reflected in the Feferholtz account was the same as for a firm trading account — that is purchases and sales of stocks or securities were made on the same day for short-term profit (13a, 14a, 41a, 44a, 113a, GX-35). The evidence is that Weinberg, who was the trader for WOH and all of whose trading profits went to WOH (61a), also made the purchases and sales for the Feferholtz account (116a-117a, 146a, 171a-172a). Defendant himself was not a trader and was

not responsible for trading any of the firm accounts (61a-62a). Moreover, a gain was realized on every transaction in the Feferholtz account, unlike any customer account or even Weinberg's firm account "A" (91a-92a). Furthermore, no commission was charged against the Feferholtz account which, although was true of a favored customer account, was always true of a trading account (43a-44a). In short, the Feferholtz account was a "WOH" trading account in every respect except that it had a name rather than a letter and was kept in a customer rather than a trading ledger (71a-72a).

This only brings us to the second stage of the inference — that the proceeds from the account were defendant's. Here, evidence provided by the Government's own witness O'Brien rebuts the inference. O'Brien told Agent King that the initial transaction in the Feferholtz account was a deposit of 150 shares of stock from WOH's trading account "A". Thus, WOH stock, not the defendant's stock started the account, and the income which arose from disposing of this stock was not defendant's income under the tax law. *Helvering v. Horst, supra.* But what about funds to purchase the other stock which was sold? If the gain from the first transaction was merely turned over in the others, then the aggregate gain was still the income of the owner of the stock which started the process — WOH. If the traded stock was acquired from another source, there was not one shred of evidence to show that defendant supplied the funds.

Consequently, far from showing that the account was defendant's and the income his, there is substantial evidence, independent of defendant's explanation, tending to show that both the account and the gains realized on the trading for the account belonged to WOH.

The Court also credited the testimony of O'Brien that on defendant's instructions WOH checks were prepared for signing, and brought to him, that it was the practice of defendant to sign WOH checks although Weinberg and Hayton signed checks in

his absence and that the amount of those checks was credited against the Feferholtz account. This testimony also requires inferences. From the fact that the checks were brought to him and the rest, it must be inferred that defendant not only signed and cashed the checks, but had unrestricted control over the proceeds. It can be said of course that defendant might by virtue of his position in the firm have done this. But it is not what defendant might have done but what he did do that was in issue. See, *United States v. Vardine*, 305 F.2d 60, 64 (2d Cir. 1962).

The evidence at trial was that defendant did not have unrestricted control over the proceeds in the account. After all the proceeds were the result of trading stock owned by WOH, not the defendant individually. Consequently, the corporation and other shareholders had a claim to the proceeds. Moreover, the trading profits were realized as a result of Weinberg's efforts as trader, not defendant's. And while the trial court disbelieved him, Weinberg's testimony on this point rings true. He testified (139a).

> "The profits were firm profits. Not only that, your Honor, I was the one doing all the transactions. All day long I am selling, buying, creating the profits. There is no way in this world after doing all that work I would permit that man [the defendant] to keep all the profits after I am doing the work. It doesn't make sense to me."

Consequently, even if the proceeds of the trading account passed through the defendant's hands, there was no consent on behalf of WOH or its other shareholders to defendant's "unfettered command" over the funds, and this real and substantial restriction prevents the proceeds from constituting defendant's income. See, *Wolder et al. v. Commissioner*, 493 F.2d 608, 612-613 (2d Cir. 1974) (a civil case where similar restrictions in the form of conflicting interests of a co-trustee prevented a finding

of constructive receipt). Moreover, the mere authority defendant had to sign checks for WOH is not proof he received the proceeds. Every person who has the power to draw a check to his order does not by that fact alone become taxable on the proceeds of the checks. See, *Hyland v. Commissioner,* 175 F.2d 442, 423-4 (2d Cir. 1949) (where a controlling shareholder who obviously could obtain payment from his company was held not to have constructively received a bonus approved by its board of directors); *cf.* Rev. Rul. 72-317, 1972-1 C.B. 128.

Finally, it is important here in the face of the "little direct evidence" that defendant received the proceeds of the Feferholtz account for his own use, that the Government failed to produce circumstantial evidence of unreported income. No recognized method of circumstantial evidence was used by the Government. No bank deposits, net worth or expenditures analysis was presented which would tend to show the taxpayer actually had unreported income for 1968 attributable to the proceeds of the Feferholtz account. Absent this evidence, the inference is justified that had such analyses been presented, no unreported income would have been indicated. See, McCormick, *supra,* §249; Wigmore, *supra,* §§285-291.

In summary the name of the account and the connection of defendant with drawing funds from the account did not constitute substantial evidence that the Feferholtz trading account proceeds were derived from his personal efforts, the disposition of his property or were subject to his "unfettered command" so that they constituted "his" income for tax purposes. As shall be shown below, absent such substantial independent evidence of income understatement, the circumstantial evidence from which the District Court inferred consciousness of guilt was insufficient to support a finding of guilt of the crimes charged.

B. The court below erroneously allowed conduct from which consciousness of guilt might be inferred to serve as proof of income understatement.

The District Court pointed to conduct of the defendant which is not proof of any specific fact or element of a crime, but which permits an inference that the defendant is conscious of having been in the wrong or that something is wrong or weak somewhere in his case. Wigmore, *supra,* §277; McCormick, *supra,* §251. That the evidence only permits an inference, and is not itself proof of guilt, is critical here, for the inferences drawn by the Court can either be shown not to have been warranted or may be explained away. The conduct cited by the Court was a fabricated explanation it determined was made with respect to the Feferholtz account, subornation and spoliation. Since this is conduct which seriously draws into question the trustworthiness of a defendant, the basis and correctness of the Court's finding must be examined.

The District Court said defendant's explanation was a fabrication because it was, to the Court at least, "inherently incredible." The defendant's case was that the Feferholtz account was a nominee of WOH, that the account was started to provide in part for the payment of cash bonuses to disgruntled back office workers, especially O'Brien, that the proceeds were put in the firm's vault and held not to pay bonuses because O'Brien left but ultimately used as part of corporate loan repayments to the Estate of Sadie Cohan. But defendant's explanation was supported by independent evidence, and no contradictory evidence was adduced. O'Brien and Freilich, both Government witnesses, testified that there was a meeting from which defendant was excluded, at which O'Brien demanded of Hayton and Weinberg that defendant keep out of the back office and that bonuses be paid. The only matter on which the testimony differed is on whether bonuses would be paid in cash — O'Brien did not say; Freilich said no; and Weinberg and Hayton said yes. But whether bonuses were to be paid in cash or not, disguising

the account would avoid payment of corporate tax, thereby leaving more of the proceeds available for the purpose. It is undisputed that the trading account was started at or about the time of the meeting in September, 1968, and was closed in November, at or about the time O'Brien left WOH, when there was no reason to accumulate amounts to pay O'Brien. It is also not disputed, although the court below also failed to give any weight to the fact, that it was WOH stock, not defendant's stock, which started the Feferholtz account.

The defendant's explanation that the Cohan loan was believed necessary as a protection for claims by customers arising out of faulty back office work seems credible, especially in light of the unanimous view that conditions in the back office during 1968 were so disorganized that liability to customers could result. Moreover, keeping the proceeds of the Feferholtz account in the form of currency in a corporate vault from late 1968 until 1970 is not inherently incredible. Initially, the loan was for 13 months only. Had this money been in a bank account, it would have been subject to the claims of all creditors of the firm, and the three partners of the firm had signed a confession of judgment and were personally liable for this particular debt. There is no evidence indicating that Weinberg, Hayton and defendant were personally liabile on any other debt of the firm. Because of the close relationship between Jerome Cohan and defendant, defendant, more than any other business loan, had a motive to insure that the Cohan loan would in fact be repaid regardless of the health of the firm. As events subsequently showed, the firm's business did founder, and this currency reserve was in fact necessary for the repayment of the loan.

The crux of the Court's disbelief was this: The implication of defendant's explanation was the indication that the nominee account was or may have been a device to evade or defeat the corporate tax of WOH, a crime prosecution for which was barred by the statute of limitations. Indeed, the trial court said

that it was "not persuaded by the defendant's attempt to admit uncharged illegal activities as a means of convincing the Court that he did not commit the crimes charged." But guilt of uncharged criminal acts is more than a matter of persuasiveness. It violates fundamental constitutional principles for a person to be tried and convicted on charges not made in the indictment against him. *Ex parte Bain,* 121 U.S. 1, 7 S. Ct. 781 (1887); *Stirone v. United States,* 361 U.S. 212, 80 S. Ct. 270 (1960). It follows that a person may not be convicted for a crime not charged in an indictment merely because prosecution for a crime he may have committed but was not charged with, was barred by the statute of limitations. Nor may Fifth Amendment guarantees be avoided merely to satisfy a believed need for punishment because a defendant's conduct has been blameworthy or indeed culpable in respect of some uncharged crime. It may be that defendant was not the most scrupulous of men during the time involved here, but the true strength of the fundamental principle that no man be compelled to answer for a charge not made by a grand jury in an indictment is precisely when the beneficiary of the application seems the most unworthy.

Apart from the inherent incredibility of defendant's explanation, the Court counted defendant's demeanor against him. But again at critical points defendant's testimony was supported by independent evidence: the meeting with O'Brien; the source of the stock in the Feferholtz account; the Cohan loan and the availability of cash to repay part of the loan. Where, as here, the testimony of a defendant is uncontradicted and not inherently improbable, a mere general observation of demeanor should be insufficient to support a finding the testimony was untrue. This is so because the demeanor of the defendant depends upon the perception of the trier of fact which is itself subject to error, Frank, *Courts on Trial,* p. 22 (1950); and the unfairness of drawing inferences from the conduct of a defendant under the influence and strains of a criminal trial should temper the natural impulses of a trier of fact. See, Wigmore, *supra,* §274.

But the District Court did more than merely disbelieve defendant. It necessarily drew the negative inference that, contrary to the explanation, the Feferholtz account proceeds were received by defendant. But a trier of fact finding a witness' testimony false may not draw a negative inference that the opposite of what the witness says is true. As Judge Hand said in *Pariso v. Towse,* 45 F.2d 962, 964 (2d Cir. 1930):

> "Upon such an issue as that at bar it might indeed be possible to argue that the owner's denial could be used in positive support of his consent. He has personal acquaintance with the fact, and the jury is certainly free to find affirmatively that his denial is untrue. Moreover, to find the denial false of something necessarily known to the witness, ought to result in finding true the proposition denied. That, however, would, at least if generalized, carry matters too far. An executor could not, for example, prove a contract with his testator by calling the promisor, and demanding a verdict because his denial was patently untrue. The law does not ordinarily cut so fine; a party must produce affirmative proof."

Similarly, the Government should not put a defendant to his proof, and then call upon the trier of fact, as it did here successfully, not only to discredit the testimony of the defendant but to make on the assumed falsity of the evidence, an affirmative finding of an alleged fact and thereby establish a *prima facie* case. The Government must produce substantial independent evidence of the alleged fact. See, *Smith v. United States,* 348 U.S. 147, 156 (1954); McCormick, *supra,* §251; Wigmore, *supra,* §277.

The circumstantial evidence which the Court said "bolstered" its conclusion that the defendant's testimony was false involved the Government's rebuttal witness Freilich. This testimony was that defendant had asked him to discredit O'Brien by falsely testifying he had received $600 from O'Brien. But the Court failed to put this testimony into perspective. O'Brien and defendant were bitter enemies. O'Brien had embarrassed defendant at the meeting at WOH. O'Brien was sufficiently aware of the enmity between himself and defendant that he transcribed the trades in the nominee account for use against the defendant. The defendant who knew that O'Brien was under investigation for tax crimes himself, could reasonably believe that O'Brien would do anything to incriminate the defendant in order to save his own skin. Having one's enemy in alliance with the power of the state against oneself is hardly a prospect that would inspire confidence that his innocence will be vindicated at a trial. In these straits, an innocent man not sure he will be able to succeed by proper means, may well resort to means of a different character. That he is guilty of the crime charged cannot therefore be conclusively inferred from his conduct. See, Wigmore, *supra,* §278. Furthermore, the sought-for testimony was inconsistent with the defendant's explanation since neither defendant nor his witnesses testified at trial that O'Brien actually received currency from the nominee account. Even assuming Freilich's testimony was true, this tends to show that, in speaking with Freilich, what defendant was attempting to do was to discredit a witness he reasonably believed would do him harm irrespective of his innocence of the crimes charged. But, in any case, it may not be inferred from defendant's conduct that his explanation at trial was false since the explanation was that O'Brien did *not* receive a bonus from the Feferholtz account proceeds.

The Court also mentioned that cancelled checks and records relating to the Feferholtz account were missing. The Court did not say that defendant was responsible for this. Special Agent King testified that in 1972 he was unable to locate cancelled

checks relating to the Feferholtz account. The trial court apparently inferred that defendant was responsible for this suppression of evidence, and further that if the evidence had existed, it would be damaging to defendant's case. However, there was no evidence that defendant destroyed the records. When King failed to locate WOH cancelled checks and daily blotter pages for the Feferholtz account in 1972, not only defendant, but Hayton in whose offices the records were kept, and Weinberg stood to gain. After all, in 1972, all three shareholders might have been charged for wilful evasion of their corporation's tax. And absence of records coupled with testimony and production of the conveniently copied customer ledger would satisfy O'Brien's desire to put the defendant precisely into the predicament he is in. Consequently, evidence that the records were destroyed was subject to other inferences than the one drawn by the Court, and thus, the inference from the evidence of spoliation that the defendant received the proceeds cannot be considered a strong one and certainly not conclusive of guilt. *United States v. Graham,* 102 F.2d 436, 442 (2d Cir. 1939).

The kind of conduct attributed to the defendant here may have been evidential of an admission, that he may have been in the wrong or that something was weak in his case. But the inference to be drawn from this conduct, even if it is believed, is indefinite and does not go to evidence that defendant received, within the meaning of the tax law, the proceeds of the Feferholtz account. Consequently, as has been required where extrajudicial admissions of a defendant are involved, the Government was required to produce substantial independent evidence of each element of the crimes charged. *Smith v. United States, supra.* Even taking the evidence in a light most favorable to the Government, there was not substantial evidence to support a finding that defendant earned the trading income of the Feferholtz account; that he owned the stock or securities disposed of in the name of that account; or that he had "unfettered command" over the proceeds of the Feferholtz

account. Moreover, since defendant was not required to report as his own, income which was not his, he may not be found guilty of filing any false statement as to his income. *Poonian v. United States,* 294 F.2d 74 (9th Cir. 1961). There being no substantial evidence to support a finding that defendant understated his income for 1968, the judgment of the trial court must be reversed.

II.

THERE WAS A FATAL VARIANCE BETWEEN THE INDICTMENT AND THE PROOF SINCE THE INDICTMENT ALLEGED EVASION OF TAX ON, AND FALSE STATEMENT AS TO DEFENDANT'S INCOME, WHEREAS THE PROOF DID NOT ESTABLISH THE INCOME IN QUESTION AS DEFENDANT'S.

The evidence in this case, taken as a whole, establishes that defendant and the other principals of WOH attempted to suppress or conceal corporate income in order to pay certain business expenses. This evidence may well have been sufficient to support a judgment of conviction of attempted evasion of or false statement with respect to corporate income taxes. However, the statute of limitations for prosecution of defendant for those crimes expired on March 15, 1975, a month before the indictment was returned against him. It is hardly coincidental that having failed to return an indictment for evasion of corporate taxes, as it might have done, the Government sought and obtained an indictment charging the defendant with evasion of and false statements with respect to his personal taxes for the year 1968. Seen in this light, the proof actually presented at trial and the effect of the District Court's judgment was to convict the defendant of attempted evasion of corporate taxes, a crime not charged in the indictment by the grand jury. Thus, there was a fatal variance between the indictment and the proof at trial, and the conviction must be reversed. *Ex parte Bain, supra; Stirone v. United States, supra.*

CONCLUSION

In view of the foregoing, the judgment of conviction for tax evasion and false statement entered by the District Court below against the defendant must be reversed.

Respectfully submitted,

s/ Michael I. Saltzman
Attorney for Appellant

. . . from the desk of

8/4/76

Gene St. Louis

Per Conversation

Please accept

the attached re-run

Briefs to replace

those filed yesterday.

As was explained,

there were 5 typographical

errors which were made.

No changes in content

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Gene St. Louis

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COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,
Plaintiff- Appellee,

- against -

HARVEY OST,
Defendant- Appellant.

Index No.

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF NEW YORK *ss.:*

I, Reuben A. Shearer *being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at* 211 West 144th Street, New York, New York 10030

That on the 3nd *day of* **August** *19* **76** *at* **One St. Andrews Plaza, New York, New York**

[redacted] *upon*

Robert B. Fiske Jr.

the **Attorney** *in this action by delivering a true copy thereof to said individual personally. Deponent knew the person so served to be the person mentioned and described in said papers as the herein,*

Sworn to before me, this 3nd *day of* **August** *19* **76**

Robert T. Brin

ROBERT T. BRIN
NOTARY PUBLIC, State of New York
No. 31-0418950
Qualified in New York County
Commission Expires March 30, 1977

Reuben Shearer

Reuben Shearer